CZAR

RESOURCES LTD.

ANNUAL REPORT

1976

BOARD OF DIRECTORS

Robert W. Lamond
Calgary, Alberta

Vernell Lindeburg
Calgary, Alberta

Rudolf Siegert
Munich, West Germany

OFFICERS

Robert W. Lamond
President & Chief
Executive Officer

Vernell Lindeburg
Vice-President

Allan R. Twa
Corporate Secretary

KEY PERSONNEL

Anna Wallace
Accoutant

Greg Fletcher
Chief Landman

Ian McMurtrie
Chief Geologist

HEAD OFFICE
1100, 550 6th Avenue South West
Calgary, Alberta T2P 0S2

LEGAL COUNSEL

Burnet Duckworth & Palmer
800 Royal Bank Building
335 - 8th Avenue South West
Calgary, Alberta

AUDITORS

Thorne Riddell & Co.
Suite #1400 - Bow Valley Square 2
205 - 5th Avenue South West
Calgary, Alberta

REGISTRAR & TRANSFER AGENTS

The Canada Trust Company
239 - 8th Avenue South West
Calgary, Alberta

ENGINEERING

D Harvey Bickell
Quace Engineering Ltd.
616 Sifton Boulevard South West
Calgary, Alberta

WHOLLY-OWNED SUBSIDIARY

Czar Developments Ltd.

STOCK LISTING

The Alberta Stock Exchange
#201, 500 - 4th Avenue South West
Calgary, Alberta

Trading Symbol - CZR

The Annual Meeting of Shareholders of Czar Resources Ltd. will be held at 2 p.m.,Friday, March 25, 1977, in the Lake Louise Room of the Calgary Inn, 4th Avenue and 3rd Street South West, Calgary, Alberta.

HIGHLIGHTS

FINANCIAL — Year ended October 31, 1976

	1976	1975
Total revenues	$ 509,863	$ 186,206
Net earnings	$ 190,635	$ 52,508
Earnings per share	20¢	11¢
Total assets	$ 3,845,849	$ 1,520,545
Working capital	$ (153,465)	$ 349,968
Shares issued	1,048,000	797,000
Return on Shareholders capital	17.0%	8.5%
OPERATING		
Reserves		
Net proven gas (BCF)	41.80	13.00
Net proven oil (BBLS)	608,000	182,000
Drilling		
Oil Completions	11	5
Gas Completions	11	12
Dry and Abandoned	5	4
	27	21
Land Holdings, Canada		
Gross Acres —		
Alberta	63,191	28,000
British Columbia	58,164	33,793

TO THE SHAREHOLDERS,

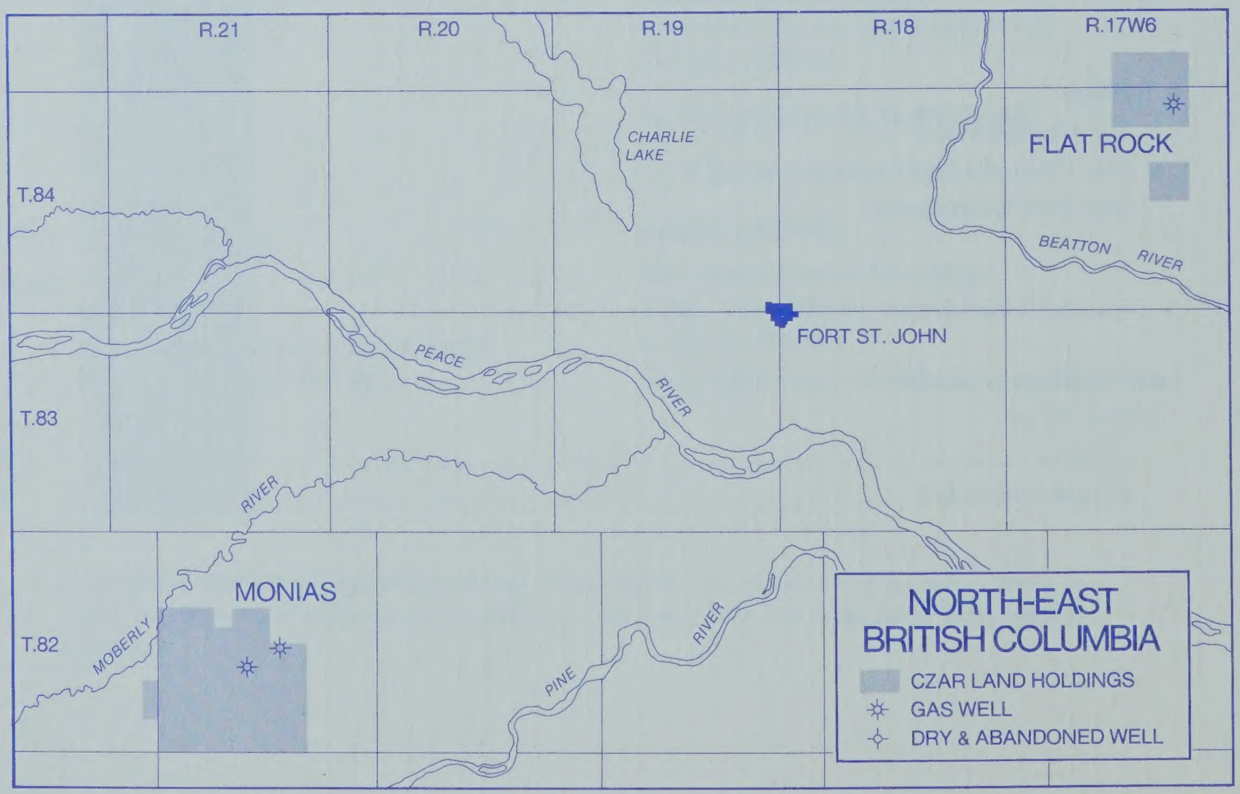
1976 was a year of major growth for Czar Resources Ltd. All significant goals in the exploration, production and financial spheres were achieved, and the Company gained a very solid base for future expansion.

Czar's net earnings increased to $190,600 or 20¢/share, compared with $52,500 or 11¢/share for fiscal 1975. Revenues from production, including amounts repaying Czar for property sales, increased to $284,200 from $7,800, illustrating the rapid success to date in placing the company's developed properties on stream. This is further amplified by the fact that first quarter production revenues for 1977 are estimated to be equal to the total for all of 1976. Due to the necessary high rate of expenditures on production facilities and development wells, working capital diminished from $349,900 to a deficit of $153,400 during the year, but a bank line of credit, our increased production revenues and a small share issue placed in December of 1976 will, together, enable the company to readily meet its commitments during 1977.

Czar continued its successful prior exploration program by concentrating on gas prospects in North-East British Columbia, and oil and gas prospects in South-Central Alberta, drilling 27 wells during the year compared with 21 wells in 1975. This program resulted in 11 gas wells, 11 oil wells and 5 dry holes, for an encouraging 81.5% success ratio. Among these wells, however, were some of the most significant drilled by the Company to date, including new pool gas discoveries at Buick, Fireweed, Jeans, Boundary, Birch and Caroline and a new oil pool discovery at Allingham. In addition, a significant extension was made to the North Twining Pekisko oil field in Alberta, and an excellent delineation well was drilled on the Monias structure in British Columbia.

British Columbia

Early in the year, two wells were completed in a new Buick Creek pool, situated to the northwest of Czar's Rigel pool. The four wells in these pools are currently on production at a cumulative rate of 10 MMcf/d of which Czar has an 18% interest.



Czar has continued its relationship with a West German drilling fund group which enlarged its second program to $3.5 million from $1.5 million during the 1974-75 season. A third fund has already been raised, in the amount of $5 million for intangible expenditures, and subsequent funds of the same or larger amounts are planned through 1977 and 1978. The considerable success of the funds, the excellent leverage obtained by Czar and the combined depth and coverage of a larger exploration program all combine to make the association an advantageous one for all parties, and one which we anticipate continuing for some time. As Czar's cash flow is rising rapidly, the Company is now participating directly in almost all prospects. This, coupled with the fact that the joint Czar-fund interest in each prospect is becoming steadily larger, means that with the same success, net reserves additions during 1977 should be much more rapid than in prior years.

During 1976, the company placed a 245,000 share issue at $2.40 per share with Canadian investors enabling Czar to obtain an Alberta Stock Exchange listing. Subsequent to our year-end, a private placement of 46,500 shares at $7.00 per share brought our issued capitalization to 1,094,500 shares.

Czar was accepted for trading on the 9th of April, 1976 and since then has had a phenomenal performance, to close out the year at $9.75 per share. This increase, of course, relates to Czar's growth of proven reserves, with a current company estimate, supported by an independent petroleum consultant's evaluation, placing a 12% discounted present value of approximately $25 per share on the stock. As the evaluation only comprises proven, fully developed reserves, exploration on Czar's considerable holdings of undrilled land is expected to increase this value substantially.

It has been gratifying during the year to see a steadily more progressive atmosphere develop in the oil and gas business, stimulated significantly by the stability of the various government's tax structures and also by the continuing increase in wellhead prices for oil and gas. Czar was most affected by the recent increase in natural gas prices in British Columbia where, effective January 1, 1977, the wellhead price of natural gas increased from 55 cents per Mcf to 85 cents per Mcf. The steady rise in Alberta oil prices, from $7.50/bbl to $9.30/bbl has also helped greatly. As these prices are still well below World price and a considerable demand-pull exists in the intermediate term, a steady rise in Czar's cash flow from existing production is anticipated. In the short term, the present surplus of Alberta gas is seen as only a minor factor in the company's growth plan, as our present reserves' division between B.C. gas and Alberta oil poses no short term contracting problems. The Company is continuing its aggressive program in British Columbia and in Alberta, where it will be drilling a higher proportion of wildcat gas prospects than before. These prospects, if productive, are mainly in the 30 Bcf range and up, and hence will be developed and on stream at about the time normal gas contracting is resumed. Finally, the intermediate energy outlook in Canada is such that without a frontier area pipeline connection, all current Western Canadian gas supplies will be fully utilized in the early 1980's.

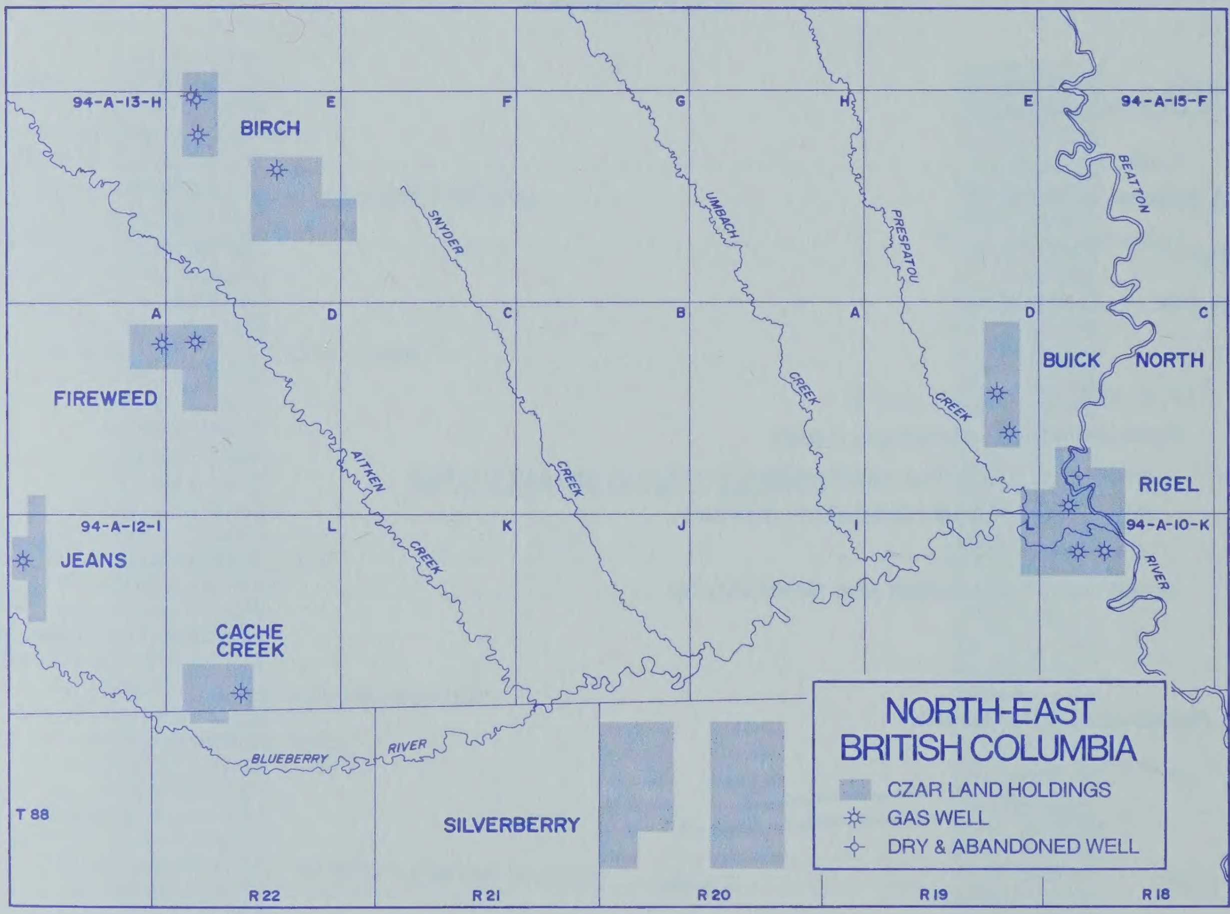
The Company has expanded rapidly in the past year encountering some of the problems which this entails, but the considerable enlargement of the exploration and support staff to handle our larger drilling program has in the main been smooth, and the Company has built a team of enterprising and dedicated professionals. In 1977, we hope to continue as before, but at an accelerating pace, and will be extending our area of exploration interest to the United States.

Presented on behalf of the board of directors.
January, 1977.

R. W. LAMOND
PRESIDENT

At Fireweed, Czar's first well encountered 12 feet of gas in the Bluesky and 52 feet in the Buick Creek zone. The well, in which Czar has a total revenue interest of 35.5%, is producing 5.5 MMcf/d from both zones, and is thereby making a significant addition to our cash flow. A step-out well encountered over 40 feet of Buick Creek pay and should be on stream shortly.

Czar has had considerable success in British Columbia in re-entering abandoned wells and stimulating them into commercial production. At Cache Creek, Jeans, Boundary and Flatrock, initial test rates of over 2 MMcf/d have been attained after stimulation, from each previously abandoned well. All of these properties are scheduled to commence producing early in fiscal 1977.



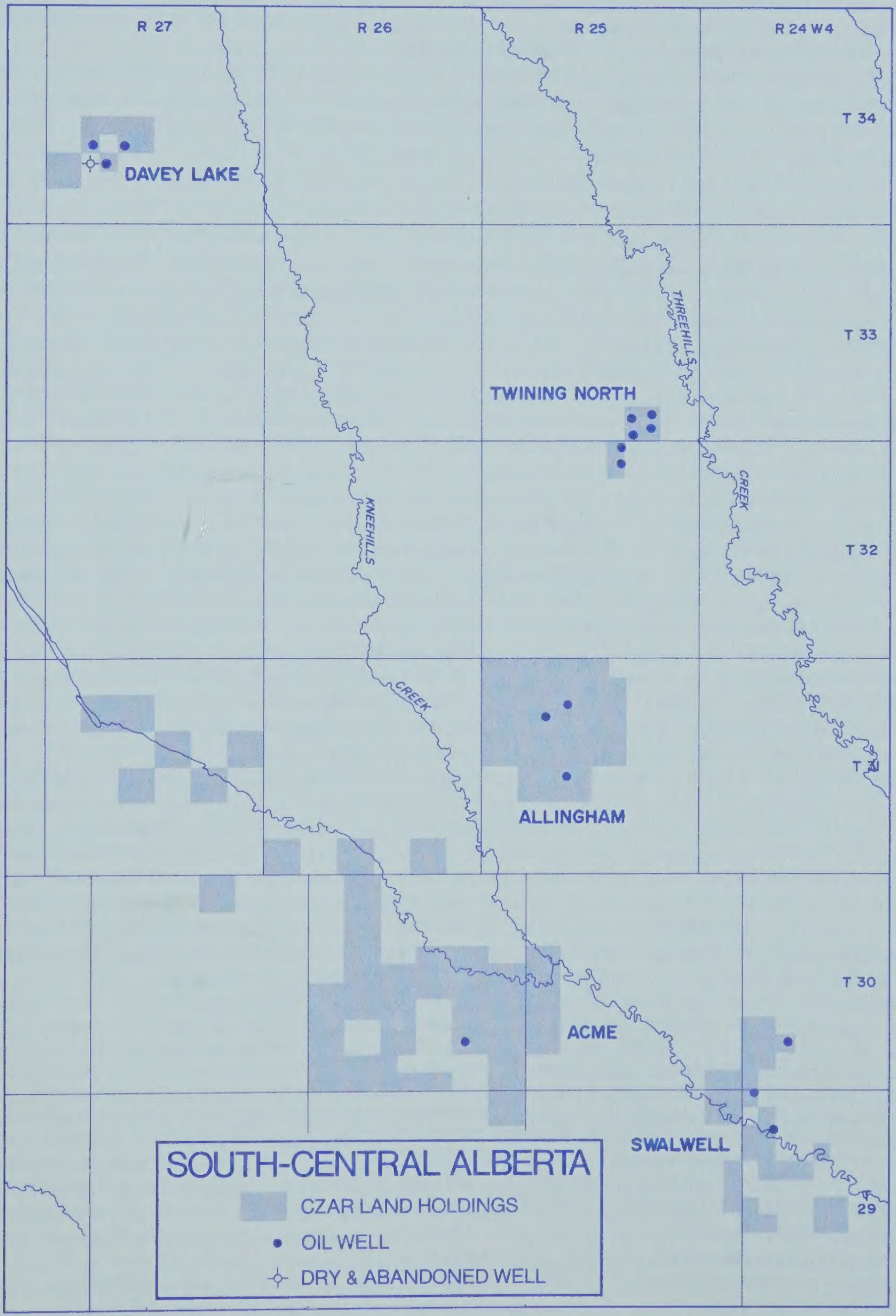
Czar's potentially most significant gas well in British Columbia is at Monias, where the 6-16 well, Czar revenue interest 26.6%, encountered a gross Halfway section of 150 feet of which 98 feet are indicated as gas-bearing from logs. On completion, gas flow rates of up to 5 MMcf/d were obtained. Subsequent to our year-end, Czar completed a two-mile step-out with similar parameters to the above well. With a current land holding of over ten sections on the crest of this structure, a major new field and asset appears to be developing for Czar.

Alberta

In Alberta, a successful development drilling project at Twining North resulted in six Pekisko oil wells with pays in the 40 to 70-foot range. An exceptional well in this group, in which Czar has a revenue interest of 21.875%, flowed initially 432 bbls/d and also tested 5.2 MMcf/d from 17 feet

of Glauconite gas pay. A tank battery has been built, and the six wells together are producing an average of 450 bbls/day. Czar has been active elsewhere in this Mississippian oil trend and has a number of wildcat and step-out wells slated for the general Allingham area, where the discovery well stabilized at a production rate of 50 bbls/d of oil and 200 Mcf/d of gas.

As a new venture, Czar has commenced working in a deeper part of the Alberta basin, north of Calgary. The first well drilled there, at Caroline, has been cased as a potential gas well. During 1977, Czar anticipates drilling at least eight wells in the 7,000 foot plus range and clearly any success should add greatly to our reserves.



CONSOLIDATED BALANCE

ASSETS

	1976	1975
CURRENT ASSETS		
Cash	$ 164,414	$ 323,553
Term deposits	200,000	150,000
Accounts receivable	1,862,034	750,292
	2,226,448	1,223,845
FIXED ASSETS (notes 1 and 2)		
Petroleum and natural gas leases and rights including exploration, development and equipment thereon, at cost	1,643,981	299,372
Accumulated depletion and depreciation	(24,580)	(2,672)
	1,619,401	296,700
	$3,845,849	$1,520,545

Approved by the Board:

R. W. [signature]
Director

[signature]
Director

EET AS AT OCTOBER 31, 1976

LIABILITIES

	1976	1975
CURRENT LIABILITIES		
Accounts payable and accrued liabilities	$2,271,191	$ 738,812
Drilling advances	108,722	135,065
	2,379,913	873,877
DEFFERED INCOME TAXES (note 1)	115,421	16,321

SHAREHOLDERS' EQUITY

	1976	1975
CAPITAL STOCK (note 3).		
Authorized		
2,000,000 common shares without nominal or par value		
Issued		
1,048,000 (1975 — 797,000 common shares)	1,138,678	609,145
RETAINED EARNINGS	211,837	21,202
	1,350,515	630,347
	$3,845,849	$1,520,545

CONSOLIDATED STATEMENT OF EARNINGS

YEAR ENDED OCTOBER 31, 1976

	1976	1975
REVENUE		
Production (note 2)	$201,658	$ 7,889
Management fees (note 2)	189,830	165,752
Interest on property transactions (note 2)	82,600	—
Interest on term deposits	35,775	12,565
	509,863	186,206
EXPENSES		
Production	30,775	2,496
General and administrative	167,445	112,581
Depletion and depreciation	21,908	2,300
	220,128	117,377
Earnings before income taxes and extraordinary item	289,735	68,829
PROVISION FOR DEFERRED INCOME TAXES	99,100	32,119
Earnings before extraordinary item	190,635	36,710
EXTRAORDINARY ITEM		
Recovery of deferred income taxes on application of prior period loss	—	15,798
NET EARNINGS	$190,635	$ 52,508
EARNINGS PER SHARE (note 4)		
Basic earnings per share		
Earnings before extraordinary item	$.20	$.08
Net earnings	$.20	$.11
Adjusted basic earnings per share		
Earnings before extraordinary item	$.20	$.07
Net earnings	$.20	$.09

CONSOLIDATED STATEMENT OF RETAINED EARNINGS

YEAR ENDED OCTOBER 31, 1976

	1976	1975
RETAINED EARNINGS (DEFICIT) AT BEGINNING OF YEAR	$ 21,202	$(31,306)
Net earnings	190,635	52,508
RETAINED EARNINGS AT END OF YEAR	$211,837	$ 21,202

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

YEAR ENDED OCTOBER 31, 1976

	1976	1975
FUNDS OBTAINED FROM		
Operations		
Net earnings before extraordinary item	$ 190,635	$ 36,710
Items not requiring funds	121,008	34,419
	311,643	71,129
Issue of common shares for cash and on conversion of advances from syndicates, net of share issue expenses (note 3)	529,533	604,895
Advances from syndicates	—	547,895
Share subscriptions receivable	—	4,248
	841,176	1,228,167
FUNDS APPLIED TO		
Fixed assets, net (notes 1 and 2)	1,344,609	276,275
Advances from syndicates	—	604,895
	1,344,609	881,170
INCREASE (DECREASE) IN WORKING CAPITAL	(503,433)	346,997
Working capital at beginning of year	349,968	2,971
WORKING CAPITAL (DEFICIENCY) AT END OF YEAR	$ (153,465)	$ 349,968

AUDITORS' REPORT

To the Shareholders of
Czar Resources Ltd.

We have examined the consolidated balance sheet of Czar Resources Ltd. and its subsidiary company as at October 31, 1976 and the consolidated statements of earnings, retained earnings and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the company as at October 31, 1976 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Calgary, Alberta
January 7, 1977

THORNE RIDDELL & CO.
Chartered Accountants

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

YEAR ENDED OCTOBER 31, 1976

NOTE 1 ACCOUNTING POLICIES

a) **Principles of Consolidation**

The consolidated financial statements include the accounts of Czar Resources Ltd. and its wholly-owned subsidiary, Czar Developments Ltd.

b) **Oil and Gas Operations**

The Company follows the full cost method of accounting for oil and gas operations whereby all costs of exploring for and developing oil and gas and related reserves are capitalized. Costs include land acquisition costs, geological and geophysical expense, carrying charges on non-producing property, cost of drilling both productive and non-productive wells, and related overhead expenses. Such costs are depleted using the unit of production method based upon estimated proven developed reserves. In calculating depletion, natural gas reserves are converted to equivalent barrels of crude oil based on the relative net sales value of each product.

Reference is made to note 2.

c) **Depreciation**

Depreciation of petroleum and natural gas production equipment and related facilities is provided on the unit of production method based on estimated proven developed reserves. Depreciation of other equipment is provided on a straight-line basis at rates which are estimated to amortize the cost of the assets over their useful lives.

d) **Income Taxes**

The Company follows the tax allocation method of accounting under which the income tax provision is based on the earnings reported in its accounts. Under this method the Company provides for deferred income taxes to the extent that income taxes otherwise payable are eliminated by claiming exploration and development costs and capital cost allowances in excess of the related depletion and depreciation provisions reflected in its accounts.

NOTE 2 DRILLING PROGRAM AGREEMENTS

The Company has entered into agreements with three limited partnerships ("the Funds") under which the Funds have the rights to acquire a working interest in substantially all of the Company's undeveloped properties, on a project-by-project basis. Upon exercise of such rights, payments made to the Company are to be derived from future net revenues of wells drilled pursuant to the agreements. Payments on account of the acquisition amounts and interest thereon made to the Company are limited to a 20%, or in the case of the third agreement a 22.5%, net revenue interest from wells

drilled pursuant to each fund agreement and, are therefore dependent upon successful commercial production from such wells. The Funds pay for all geological and intangible costs plus a management fee. The Company is responsible for well completion costs.

Under the Company's accounting policies, payments made by the Company under these agreements are recorded as additions to fixed assets, and management fees charged by the Company are credited to earnings. The profits (losses) on disposition of properties will be included in earnings on receipt of the applicable proceeds. To October 31, 1976, the Company had sold properties to the Funds for $7,739,078 of which $293,940 has been received.

NOTE 3 CAPITAL STOCK

a) Changes in the Company's capital stock for the year ended October 31, 1976 were as follows:

	Number of Shares	Consideration
Balance, October 31, 1975	797,000	$ 609,145
Shares issued for cash, less applicable share issue expenses of $68,717	245,000	519,283
Shares issued for cash pursuant to option to purchase common share agreements	6,000	10,250
Balance, October 31, 1976	1,048,000	$1,138,678

b) The Company has granted options to purchase common shares of the Company to certain employees and a consultant employed by the Company. At October 31, 1976, there were outstanding options to purchase 26,000 shares which are exercisable from time to time to June, 1979 at prices ranging from $1.50 to $2.90 per share.

Changes during the year ended October 31, 1976 in the number of optioned shares were as follows:

Outstanding at October 31, 1975	20,000
Options granted	12,000
Options exercised	(6,000)
Outstanding at October 31, 1976	26,000

c) Reference is made to note 6.

NOTE 4 EARNINGS PER SHARE

Basic earnings per share have been computed using the weighted average number of shares outstanding during the year.

Adjusted basic earnings per share for 1975 show the effect on the basic earnings per share by using the weighted average number of shares that would have been outstanding during 1975 had common shares been issued on receipt of the cash advances.

NOTE 5 STATUTORY INFORMATION

During the year the Company paid remuneration of $103,911 to its senior officers (including the five highest paid employees). The Company paid no remuneration to its three directors in their capacity as directors during the year. Two of the directors are also officers of the Company.

NOTE 6 SUBSEQUENT EVENT

In December of 1976, the Company issued 46,500 common shares for a cash consideration of $309,225.

CZAR

RESOURCES LTD.

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